COLUMN

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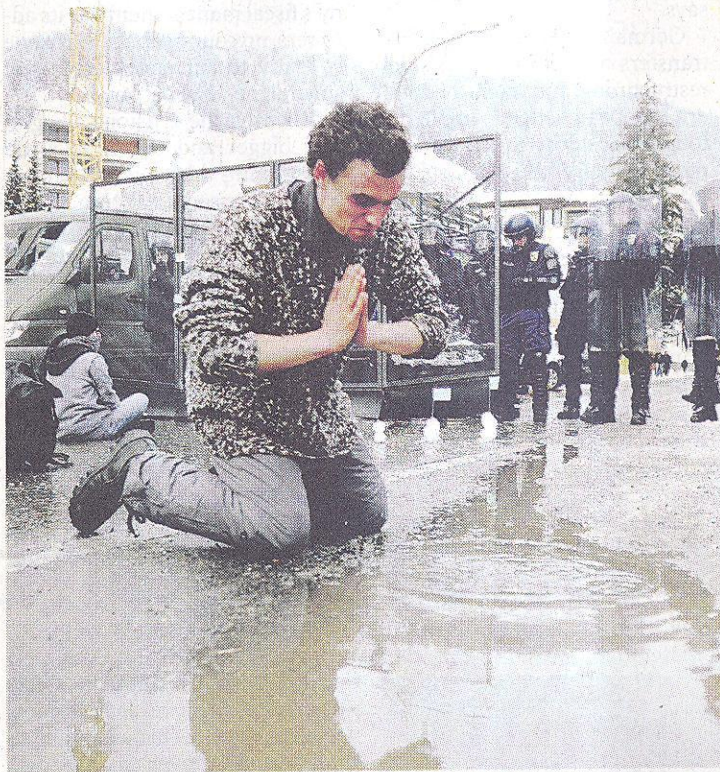
Davos destiny

THE WORLD Economic Forum's flagship event — the Annual Meeting — was held last weekend at the Swiss resort of Davos that brought together CEOs from the WEF's 1,000-member companies as well as selected politicians, representatives from academia, NGOs, religious leaders and the media. The event discussed on various topics impacting the global economies.

Over the next decade, GDP growth will be divided equally between developed and developing countries. The world has the potential of adding $30 trillion in GDP growth during the next 10 years. Engines of growth include growing middle classes in developing countries, investment in infrastructure and human capital development, and meeting the needs and wants of growing numbers of older people. There are new opportunities for growth in developing countries for the consumer goods, financial services, construction and defence sectors. Developed countries should not see employment and economic growth in developing countries as a zero-sum game. Western companies will also benefit from participation in infrastructure projects in the developing world. United States' economy growth will depend on "how the world unfolds", including the crisis in Europe. Policy challenge is to restore confidence and put an end to the crisis in the euro area by supporting growth, while sustaining adjustment, containing deleveraging, and providing more liquidity and monetary accommodation. In other major advanced economies, the key policy requirements are to address medium-term fiscal imbalances and to repair and reform financial systems, while sustaining the recovery. In emerging and developing economies, near-term policy should focus on responding to moderating domestic growth and to slowing external demand from advanced economies.

The world is facing a new era of global catastrophes, driven by inter-dependency, complexity and the velocity of change. Systemic global risks such as resource scarcity, water security and climate change expose the underlying fragility of existing safeguards. Existing safeguards against global risks are inadequate. There is no reliable system of global governance to deal with emergent and systemic risks. Regulations are not the only answer. The unintended consequences of regulations are tightly coupled with many other global risks. Existing processes for setting regulations tend to focus on specific industries or actions and are often fragmented and backward looking. However, global regulations can play a level playing field — particularly bank resolution and contingent capital mechanisms which help address the "too-big-to-fail" issue. Global mechanisms are needed to improve coordination and collaboration, set appropriate incentives and internalise the cost of externalities. The emergence of technology as a force in geopolitics and connectivity as an element of national security forces a rethinking of related global risks. A major challenge will be to prevent the emergence of a stratified online society, as wealthy states and institutions equip themselves with costly protection technologies while the rest of the world falls behind. The European debt crisis and deleveraging pose serious risks to global financial system.



Hopes were high that the Davos talks would produce results. — AFP

The way out of problems lies not only in austerity but also through growth. Banks prepare for the worst-case scenario of eurozone break-up. The impact is already being felt in the real economy, as the US and other developed countries have cut their expected GDP growth rates for 2012. The developing world will also not be immune, having traditionally relied heavily on European banks for trade financing. At a macro level, the global savings gap issue has compounded the challenge to finding a solution. As long as developing countries continue to accumulate reserves and developed countries continue to spend beyond their means, a European solution alone will not remove the global imbalances that have contributed to the festering problems. Banking and governance reforms instituted after the collapse of Lehman Brothers were necessary and have helped banks to improve their capital and liquidity positions considerably, even if massive capital raising by banks has curbed their lending capacity.

The US economy is susceptible to a range of shocks from the eurozone crisis, including attacks on the financial sector. Potential spillovers could include direct exposures of US banks to euro-area banks, or the sale of US assets by European banks. A large shock from the euro area could be magnified by existing weaknesses, notably in the still-fragile US housing market. Deleveraging by European banks, combined by losses from further sovereign-debt woes, could cause a credit crunch in Europe that would reverberate around the globe, pulling trade and investment out of emerging and developing economies, and squeezing the US exposures through the credit-default swap market are significant for US banks.

Banking reforms are still a work in progress — there is still a long way to go before the global banking system can be considered robust. A key focus is large, systematically important banks which proved "too big to fail" during the crisis. However, an orderly unwind of a global, complex financial institution is unrealistic. For banks that cannot be broken up, the focus must instead be on measures such as living wills, resolution mechanisms and the use of contingent capital. Big banks are not the only issue — preventing the failure of large numbers of small and regional banks is just as important. Short-term costs of regulation are worth paying to ensure long-term sustainability of the financial system. There is an overriding concern for regulatory consistency to ensure a level playing field at the global level. Without agreement on measures for cross-border resolution, addressing future banking crises will inevitably fall on national authorities. The Volker rule, if passed into law, will have negative consequences by significantly raising borrowing costs for sovereign borrowers and firms overseas.

The writer is the group chief executive of Doha Bank. Views expressed are his own and do not reflect the newspaper's policy.